13 Constitutional economics

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Introduction

The term 'constitutional economics' or 'constitutional political economy' was introduced in the 1970s to designate a distinct strand of research that emerged from the somewhat older public choice branch of economics.[1] In the 1990s, constitutional economics developed into a major research programme. At a time of massive worldwide constitutional change, it came as no surprise that the focus of public choice discussion was shifted away from ordinary political choices to the institutional-constitutional structure within which politics takes place.

However, the subject matter is not new. Broadly conceived, constitutional economics is an important component of a more general revival of the classical approach. It draws substantial inspiration from the encompassing theoretical perspective and the reformist attitude that were characteristic of Adam Smith's vision. Buchanan's constitutional political economy can be considered the modern-day counterpart to what Smith called 'the science of legislation', an academic enterprise that seeks to bring closer together again the economic, social, political, philosophical and legal perspectives that were once part of the study of 'moral philosophy'.

One might be tempted to characterize constitutional political economy simply - and somewhat narrowly - as 'the economic analysis of constitutional law'. It cannot be denied that the examination of real-world constitutions using the perspective of modern constitutional political economy is an interesting exercise and may provide a kind of test for the usefulness of this approach. Reference can be made to several interesting case studies.[2] However, such a definitional strategy may tend to be somewhat misleading. The use of the term 'constitutional' in the self-description of the subdiscipline is largely metaphorical. Constitutional economics as a research field comprises but is at the same time broader than, 'the economic analysis of constitutional law'.

Constitutional economics as a scientific subdiscipline is characterized by a particular kind of orientation in social analysis. Whereas orthodox economic analysis attempts to explain the choices of economic agents, their interactions with one another and the results of these interactions, within the existing legal-institutional-constitutional structure of the polity, constitutional economic analysis attempts to explain the working properties of alternative sets

of legal-institutional-constitutional rules that constrain the choices and activities of economic and political agents. The emphasis is on the rules that define the framework within which the ordinary choices of economic and political agents are made. Thus constitutional economics analysis involves a 'higher' level of inquiry than orthodox economics. It examines the choice of constraints as opposed to the choice within constraints. Thus the constitutional economist has nothing to offer by way of policy advice to political agents who act within defined rules. On the other hand, the whole exercise is aimed at offering guidance to those who participate in the discussion of constitutional change. Constitutional economics offers a potential for normative advice in constitutional matters, whereas orthodox economics offers a potential for advice to the practising politician.

A preliminary illustration may be drawn from the economics of monetary policy. Events in the European Monetary System, on the one hand, and monetary disintegration in the former Soviet Union, on the other, have revived interest in the question of how to design and choose a monetary regime for both parts of Europe that ensures monetary stability. The constitutional economist is not directly concerned with determining whether monetary ease or monetary restrictiveness is required for furthering stabilization objectives in a particular setting. However, he/she is directly concerned with evaluating the properties of alternative monetary regimes (such as complete monetary union versus currency competition).[3]

Of course, there exists a whole set of subdisciplines that all draw some attention to the legal-political constraints within which economic and political agents choose. Differences can be identified, however. Thus public choice, in its non-constitutional aspects of inquiry, concentrates attention on analyses of alternative political choice structures and on behaviour within those structures. Its focus is on predictive models of political interactions, and is a preliminary stage in the more general constitutional inquiry. Law and economics remains somewhat closer to orthodox economic theory than constitutional economics or public choice. The standard efficiency norm remains central, both as an explanatory benchmark and as a normative ideal.

One of the leading journals of the subdiscipline is *Constitutional Political Economy* (CPE). Some intuitive understanding of what constitutional political economy is all about can be gained from explaining the logic behind the logo of this journal, which is drawn from Greek mythology. The logo is a representation of the familiar Homeric account of how Ulysses heard the sirens singing, and survived (Kliemt and Brennan, 1990). Ulysses wanted to hear the exquisite voices of the sirens. He was passing close by and, in principle, there was nothing to prevent him from listening to them while continuing his journey. However, he recognized that the power of these voices was such that he would steer the ship ever closer to the rocks where

the sirens were located. The ship would be wrecked and he would be unable to continue his journey.

Formally, Ulysses faced a problem of time inconsistency in his optimal plan. His optimal plan was to listen to the sirens and then continue his journey. But this was time- inconsistent because, once he had embarked on the plan by listening to the sirens, he would not have been able to implement the later part of the plan, the rest of his journey. By contrast, a time-consistent optimal plan is one that specifies a sequence of actions (A_t, A_{t+1}, A_{t+2} and so on), one for each moment in time (T, T + 1, T + 2 and so on), which enjoys the property that the individual will actually choose in each time period the action specified by the plan. Thus, when T + 1 occurs, having undertaken A_t in T, the individual will still choose A_{t+1} as the best action rather than some other, and so on.[4]

The time inconsistency arises because the sirens affect Ulysses' preferences. His perception of the best action changes in the middle of the plan and this leads him to deviate from the original version. Ulysses implemented his optimal plan by denying himself freedom at the later stage of the plan. Having instructed his men to tie him to the mast and to ignore any orders to do anything other than sail past the rocks, he told them to plug their ears and row. Thus, Ulysses established for himself a private constitution, a set of more or less binding rules that constrain his future choices. By exploiting elements of his natural and social environment, Ulysses was able to subvert certain inclinations of his future self, inclinations that he knew would be destructive of his overall interests but which would nevertheless prove irresistible when they arose.

Though the theory of private constitution is a (small) part of the domain of constitutional political economy (Buchanan, 1990, p. 3), the principal issue for constitutional political economy is that of forming a mutually agreeable constitution for social arrangements among a community of persons. Ulysses is therefore to be seen not merely as a single actor but more particularly as representing society as a whole, and the mast and rope are to be identified as the rules by which ordered society is governed.

As Kliemt and Brennan (1990, p. 125) point out, some care must be taken in interpreting any such image. Following the individualist methodology, 'social action' must be decomposed into the actions of the individuals of whom society is made up; the exercise of social binding, specifically, must be seen as an intrinsically multilateral activity. Each agrees to a set of rules and procedures because this is the price each must pay to restrict the conduct of others. 'Weakness of the social will' will arise precisely because it is opportunistically rational for any individual to depart from the collectively agreed rules and procedures.

Moreover, in the setting with which constitutional economics is concerned, there is no external technology available that is totally effective or that is not

excessively costly. The tools of enforcement and maintenance must themselves be socially constructed. Human beings are not bound by nature to pursue rules: they are endowed with the capacity to deviate from rules if it is profitable to do so. Accordingly, we must search out rules which so order individuals' behaviour that it is individually profitable for most people to keep and enforce those rules most of the time. The gains from violation should not be too great. The analysis of the kind of rules and the associated institutional apparatus that exhibit these properties represents a centrepiece of constitutional political economy as an area of inquiry.

Theoretical foundations and intellectual origins: the Wicksellian ancestry

Constitutional economics is informed by an explicit methodological individualism (Buchanan, 1990, p. 13). Only individuals choose and act. Whatever phenomena at the social aggregate level we seek to explain, we ought to show how they result from the actions and interactions of individual human beings who, separately and jointly, pursue their interests as they see them, based on their own understanding of the world around them (Vanberg, 1994, p. 1).

Beyond the logical - and largely tautological - presuppositions of individualism, orthodox public choice models usually obtain operational content through the postulate of *homo economicus.* Individuals are assumed to be utility-maximizing and to seek their own interests. It is increasingly recognized, however, that at least a part of the traditional public choice emphasis had been wrongly placed. Thus the emphasis is shifted away from the motivational postulates for political actors to the incentive structures of politics. In Buchanan (1993a, p. 69) it is argued that the seminal Alchian (1950) analysis of the market's analogue to evolutionary selection can be extended to politics in a relatively straightforward fashion, the difference between the two evolutionary models lying in the compatibility with overall efficiency. The structure of the politics in which politicians act requires them to act contrary to the public interest if they are to survive at all. For the constitutional economist the relevant question then becomes: 'How can constitutions be designed so that politicians who seek to serve "public interest" can survive?' (Buchanan, 1993b).

The germs of the recent re-emergence of the research programme of constitutional political economy were contained in *The Calculus of Consent* (Buchanan and Tullock, 1962; also Wagner, 1988 and Tullock, 1987). The distinguishing feature of the Buchanan and Tullock approach to the study of political institutions from a normative viewpoint was to treat the political process by which individuals advance their interests as one of exchange. In adding this second element - 'politics as exchange' - to the utility-maximizing models for individual choice behaviour in politics, they were directly influenced by the great work of Knut Wicksell.

Constitutional political economy could be characterized as 'Wicksellian' political economy. In his basic work on fiscal theory, Wicksell (1896) called attention to the significance of the rules within which choices are made by political agents, and he recognized that efforts at reform must be directed towards changes in the rules for making decisions rather than towards modifying expected results through influence on the behaviour of the actors. In order to take these steps, Wicksell needed some criterion by which the possible efficacy of a proposed change in rules could be judged. He introduced the now familiar (near to) unanimity or consensus test. Thus, for Wicksell, 'the consent of the governed' was the point of departure for the evaluation of government activities. As he concluded:

> It is a necessary condition that expenditures and the means of financing them be voted upon simultaneously. ... If this procedure should become general practice, a very important practical step would have been taken in the direction of the system proposed in this essay. The requirement of the veto right of the minorities would follow sooner or later as a logical and necessary consequence. … It stands to reason that a combination which satisfies everyone ... must be imbued with more justice than any other which might appeal more to an accidentally greater half of those interested, but which would be at the expense of the others. Once this is conceded, the right of minority veto is already recognized in principle. (Wicksell, 1896 [1962], p. 116)

This 'Wicksellian' idea has had considerable influence on Buchanan's approach. Buchanan maintains that politics must be understood according to the model of market exchange. Thus the political process is conceptualized as one of mutually beneficial exchange. It is for this reason that he is drawn to unanimity as a collective decision rule. Since the choice among rules is more a social choice than an exchange, the form of voluntary exchange is political consent. At the most fundamental level of constitutional choice, consent serves as the basis of justification. It provides the ultimate criterion of efficiency. Unlike other economists who have emphasized either the efficiency or rationality of rules, Buchanan is concerned exclusively with whether or not people consent to them. Through the emphasis on 'consent' or 'agreement' as a normative yardstick, the research programme of constitutional political economy became closely related to the contractarian tradition in political philosophy (Buchanan, 1975). In contrast with Paretian 'optimum resource allocation', a situation of 'Wicksellian efficiency' will be characterized by the fact that citizens are satisfied that the extant system of rules, institutions and policies of their society is free from improper coercion (Wiseman, 1990, p. 110).

Thus Buchanan and traditional economic analysts develop the relationship between autonomy and efficiency in exactly opposite ways (Coleman, 1990, p. 141). Traditional economists believe that efficiency can be defined as a

property of social states independent of the process of voluntary exchange. For example, the perfectly competitive market is efficient, but the outcome of the prisoner's dilemma is not. And given the logic of the relevant concepts - especially Pareto superiority - it follows logically that people would consent to efficient rules. Consent follows from efficiency. Buchanan puts the matter exactly the opposite way. What people consent to is efficient. Efficiency follows from consent.

As Buchanan sees it, contractarian political institutions typically exhibit three attributes. First, the place of the individual is central to the contractarian vision of the political process. Individuals' own - and necessarily subjective - evaluations, their interests and values constitute the relevant benchmark or criterion against which the efficiency or desirability of alternative sets of rules are to be judged. Contractarianism complies with this criterion by according each individual equal treatment at the constitutional stage. This normative individualism should be distinguished from the methodological individualism discussed above.

Second, there is the fundamental distinction between actions taken within the constitutional rules, and changes in the rules themselves. The latter are to occur only at the constitutional stage and ideally are made using the unanimity rule. Whereas Wicksell did not move beyond the development of criteria for evaluating policy alternatives one at a time, Buchanan and Tullock (1962) operationalized Wicksell's (1896) insights and extended the applicability of the unanimity or consensus criterion from the level of particular proposals to the level of rules - to constitutional rather than post-constitutional or in-period choices. The image of political activity as a two-stage process, first developed in *The Calculus of Consent,* recurred in many of Buchanan's later writings as a sort of normative benchmark or yardstick by which to measure the quality of a community's political institutions.

Third, actions taken in the second stage of the political process should be effectively constrained by the rules written in the first, constitutional stage, and this is true, not only for the individual citizen, but also for the elected representatives, and the bureaucrats and jurists who administer the system.

The shift of the Wicksellian criterion to the constitutional stage of choice has some remarkable consequences. It becomes conceivable to allow for the possibility that preferred and agreed decision rules might embody sizeable departures from the unanimity limit, including simple majority voting in some cases and even less than majority voting in others (Buchanan, 1987, p. 135). The constitutional calculus suggests that both the costs of reaching decisions under different rules and the importance of the decisions are relevant. Since both of these elements vary, the preferred rule will not be uniform over all ranges of potential political action. The in-period Wicksellian criterion may remain valid as a measure of the particularized efficiency of the

single decision examined. But the in-period violation of the criterion does not imply the inefficiency of the rule so long as the latter is itself selected by a constitutional rule of unanimity.

For Buchanan and Tullock (1962, ch. 6) constitutional design was a matter of comparing the interdependence costs of public and private decisions over a range of activities to determine which activities would be assigned by the constitution to the state and which voting rule or choice mechanism would be specified by the constitution for each state activity. The best public decision rule for each activity was the one that minimized interdependence costs. It was specified that the representative individual perceived interdependence costs for an activity as the sum of the anticipated external costs levied on that individual if not part of the decision set, and the anticipated decision cost experienced by the individual if part of the decision set. The sum of both external and decision costs was shown to have a unique minimum somewhere between the extremes of individual rule and unanimity rule, the exact position depending on relative external and decision costs.

Thus, while it was recognized that unanimity and not majority rule is the pivot of constitutional democracy, it was equally demonstrated that 'at best, majority rule should be viewed as one among many practical expedients made necessary by the costs of securing widespread agreement on political issues when individual and group interests diverge' (ibid., p. 96).

The general problem of efficient constitution formation and maintenance

The choice situation at the constitutional as well as the post-constitutional stage is ususally modelled as a classic prisoner's dilemma (Figure 13.1), at least in so far as it involves potential conflict of interests between rational persons (Gwartney and Wagner, 1988a, p. 32; Buchanan, 1993b, p. 2). In 'generalized prisoner's dilemma situations', that is, social constellations under which individuals, in separate and rational pursuit of their own interests, unintentionally but system-

		B	
		C	D
A	C	3,3	1,4
	D	4,1	2,2

Figure 13.1 Classic prisoner's dilemma

atically contribute to an overall outcome that is undesirable for all of them (or in any case less desirable than some alternative outcome that could be realized by concerted, organized action) there may exist a potential for mutual gains by collective action (collective organization).

Thus the constitution is essentially a contract intended to secure the mutual gains from social cooperation and to avoid the dominant defective strategy in the prisoner's dilemma game which leads to a socially inefficient Nash equilibrium solution. Since the mutual gains from social cooperation constitute a public good, the maintenance of the constitutional contract gives rise to a problem that will not resolve itself naturally.

Even when it is supposed that agreement on appropriate rules can be achieved at the stage of constitutional contract formation, it should be recognized that individuals and interest groups inevitably will attempt to engage in post-contractual opportunism (the problem of constitutional maintenance). Thus the agreement, once achieved, must be enforceable. This opportunism takes several forms. First, each individual may have an incentive subsequently to defect from the cooperative agreement (the compliance or unilateral defection problem). Whether or not it is rational for persons to comply with rules that they constitutionally may agree on is a matter of contingent, factual circumstances. It depends on whether or not the constraints that persons face after the agreement, that is post-constitutionally, make it rational for them to comply with previously agreed rules.

A second form of post-contractual opportunism consists of rent seeking and special-interest plundering which ultimately reduce the value of post-contractual cooperation and undermine the constitution itself. Groups of individuals have an incentive to seek to capture the instruments of state power and to use them as vehicles to enrich themselves in ways that are not possible for private citizens. 'Rent seeking' is a term used by economists to describe actions taken by individuals and groups to alter public policy in order to gain personal advantage at the expense of others. The social costs entailed by this process are called 'rent-seeking costs' or, by some, 'Tullock costs', after Tullock (1967).[5] Tullock showed not only that the inefficiency or social welfare cost of, say, a tariff consists of the *Harberger triangle* and can increase with the *Tullock rectangle,* but also that the pure transfer involved in the creation of tariffs or other privileges will lead market participants to expend resources in lobbying and political activities:

> These expenditures, which may simply offset each other to some extent, are purely wasteful from the standpoint of society as a whole; they are spent not in increasing wealth, but in attempts to transfer or resist transfer of wealth. I can suggest no way of measuring these expenditures, but the potential returns are large, and it would be quite surprising if the investment was not also sizable, (ibid., p. 228)

The incentive to engage in rent-seeking activities is directly proportional to the ease with which the political process can be used for personal (or interest group) gain at the expense of others. In other words, distributional politics is viable and tends to become dominant to the extent that differential treatment is constitutionally permissible (Buchanan, 1993b, p. 6).

Tullock (1959) had shown that under any voting system which requires less than unanimous approval to implement policies, majority coalitions of interest groups will seek to obtain public provision of special interest projects. The dominant strategy for any organized interest group in a majoritarian polity is to lobby for policies which provide large benefits to its members and spread the costs among everyone else. This tendency exists even in liberal democracies. Through implicit vote trading, a coalition of interest groups, comprising a bare majority of voters, can get all or at least most of their favoured projects approved for public provision. Under certain conditions, the total costs of these projects can exceed their total benefits, while cost-spreading through the 'fisc' induces a rational ignorance of this process on the part of the disadvantaged majority. On the other hand, the asymmetric distribution of cooperative benefits leads subgroups of the collective to invest energy struggling for access to the government's coercive power. But the effort may turn out to cost more than it is worth and the end result will be that the collective's loss purchases the subgroup's gain (Schmidtz, 1991, p. 91).

Buchanan and Lee (1991) demonstrate that the gains from politically generated restrictions on markets, even to organized producing interests, are more apparent than real. The analysis demonstrates that, under plausibly realistic assumptions concerning coalitions sizes, excess burdens, organizational costs and rent-seeking outlay, a genuine utility-maximizing calculus may dictate support for constitutional prohibition of all market restrictions, by all members of the polity, including those producer interests that might be considered to be the potentially identifiable beneficiaries of cartelization.

Principal-agent theory has been used to examine the rent-seeking problem (Anderson and Hill, 1986; Merville and Osborne, 1990).[6] The principal, also the citizen, grants the agent (the government) the power of coercion. In exchange, the agent supplies the principal with public goods. Since the capitalized value of public assets is owned collectively, public good outputs of the government are like communal resources with widely diffused benefits. It soon becomes evident to vote-maximizing agents or legislators that they can maximize their political support by significantly reducing the provision of public goods to the population at large in favour of greater transfers to interest groups. These transfers are financed by general tax collections and provide concentrated benefits to designated groups. Such collusion between agents and special interest groups will invariably lead to a breaking of the constitutional contract.

Merville and Osborne (1990) use agency theory to demonstrate formally that, in majority-rule political systems, coalitions of minority factions will induce politicians to break the constitutional contract systematically in order to supply special-interest projects. Unlike contracts in private markets, political contracts are much more susceptible to this kind of opportunism.

Proposed solutions

Is the rent-seeking trap inescapable? By far the most important problem with respect to ensuring the self-enforcing character of a constitutional contract is that it must successfully constrain the power of the state itself.

Substantive restraints versus procedural rules

Generally speaking, substantive constraints on government have been dismissed as ineffective precisely because of the wide latitude they allow for reinterpretation. Gwartney and Wagner (1988a, pp. 44-9) make a strong case for procedural rules designed to uphold decentralization of governmental powers and to prevent the formation of legislative coalitions. Procedural rules will provide more effective mechanisms for self-enforcement than will substantive restraints on government. In their view, the weakness of substantive restraints derives from the politicization of the Supreme Court and the ease with which legislatures can find alternative ways to implement any given policy. They propose procedural rules requiring larger legislative majorities for legislative action at higher levels of government, thereby diffusing the power of the state to regional and local governments.

Judicial independence

Does independence of the judiciary serve the long-term public good? The traditional view of the purposes of judicial independence has been attacked as naive by law and economics and public choice scholars. Unlike many legal contracts, it is argued, there is no third-party enforcer, external to the contract, who can ensure that defectors are caught and forced to comply with the terms of the agreement. Although many countries have a nominally independent Supreme Court whose purpose is to enforce the constitution, the Supreme Court can only do this imperfectly in most cases, because the judges themselves are not totally immune from political pressures by groups wishing to subvert the original intent of the constitution. Thus, given the unreliability of third-party enforcement, and given the strong individual incentives to defect from social cooperation, the constitutional contract should somehow be self-enforcing if it is to be maintained.

The interest group theory first advanced by Landes and Posner (1975) makes the independent judiciary an integral part of the system of rent seeking engineered by Congress. However, the debate goes on. A very detailed criti-

cism of the Landes-Posner theory in contained in Boudreaux and Pritchard (1994), who argue that the theory is seriously deficient and conclude that the United States federal judiciary is truly independent of Congress and the president, and that this independence was designed by the US Constitution's framers as a means of furthering sound government.

A rule of law in politics

According to Buchanan (1993b) the direction of constitutional reform is obvious. If, somehow, the potential for differential treatment is reduced, so will be the inducement to rent-seeking behaviour. The off-diagonal solutions should simply be made impossible to achieve by the introduction of some rule or norm that prevents participants from acting or being acted upon differently, one from the other. If the off-diagonal attractors are eliminated, then the players operate with the reduced matrix shown in Figure 13.2. Thus the constitutional reform measure modifies the original prisoner's dilemma game into a reduced setting in which each player, as a member of a political coalition, knows that any choice of an action or strategy must involve the same treatment of all players or constituencies (ibid., p. 3).

		B	
		C	D
	C	3,3	X
A			
	D	X	2,2

Figure 13.2 Modified prisoner's dilemma

If and to the extent that differential treatment is replaced by equal treatment, or by the principle of generality in politics - analogous to that present in an idealized version of the rule of law - mutual exploitation will be avoided and politicians who seek to serve the 'public interest' will survive and prosper (ibid., p. 6). Thus it seems at least conceivable that rational persons, at the stage of entering into the agreement, may recognize the 'rent-seeking trap' and engage in concerted effort to escape.

However, in the hypothetical matrix construction above, the interaction was in fact assumed to occur in a state of nature, with each person holding equal prospects for membership in the majority and minority coalitions. This means that membership was assumed to be symmetrical among all partici-

pants. But this assumption may turn out to be too heroic with respect to real-world settings.

The prospects may differ among persons and groups of persons so as to create divergences in interests which may become a source of disagreement. Thus the question remains whether it is possible to modify the constitutional choice setting so as to reconcile such possible divergences. It appears that, at least from the perspective of potentially-conflicting interests among constituencies, the general problem of constitutional efficiency and survivability does not resolve itself naturally.

Veil of uncertainty and/or ignorance versus the availability of exit options

Is it possible to specify the conditons under which constitutional agreement may be facilitated in real, non-hypothetical choice situations? Is it possible to modify the constitutional choice setting so as to reconcile divergences in interests? In this respect, two lines of reasoning have been pursued in the contractarian and neo-contractarian literature. The first line of argument focuses attention on the need for a 'veil of uncertainty and/or ignorance' as a precondition for an efficient constitution.

Buchanan and Tullock (1962) had to present a convincing positive argument that unanimous consent at the constitutional level was possible at all. How can agreement on rules among persons with potentially conflicting constitutional interests be achieved? The authors' characteristic way of approaching this issue consists of emphasizing the uncertainty confronting all individuals taking part in constitutional deliberations. The existence of 'a veil of uncertainty' induces individual participants in a constitutional process to prefer rules that do not systematically favour any particular subset of citizens.

The proposed remedy involves the introduction of some means of ensuring people's inability reliably to foresee their future particularized interests, as these may be affected by different rules, thereby inducing people to make constitutional choices on some assessment of the general working properties of alternative rules, and divorced from particularized interests. Thus agreement is facilitated by whatever increases people's uncertainty about the particular effects that alternative rules can be expected to have on them. In fact the assumption of a 'veil of uncertainty' was also hidden in Buchanan (1993b), discussed above.

Buchanan's approach has affinities with John Rawls's (1971) construction, which utilizes the veil of ignorance along with the fairness criterion to derive principles of justice that emerge from a conceptual agreement at a stage prior to the selection of a political constitution. Thus in Rawls's construction, the prospect of agreement is secured by defining certain 'ideal' conditions under which constitutional choices are hypothetically made. The choosers are assumed to be placed behind a 'veil of ignorance' which makes it impossible

for them to know anything specific about how they will be personally affected by alternative rules. Ignorant about their prospective specific interests in particular outcomes, they are induced to judge rules 'impartially'. Potential conflict in constitutional interests is not eliminated, but the veil of ignorance transforms potential interpersonal conflicts into intrapersonal ones (Vanberg, 1994, p. 170).

However, the constitutionalist notion of a veil of uncertainty or ignorance, though useful as an analytical benchmark, is not very practical. It is not clear how genuine uncertainty or ignorance could be achieved in real-world constitution formation. Therefore, it has been argued that the availability of exit options can ensure a competitive setting for participants in constitutional deliberations and can even substitute for a veil of uncertainty. This condition for efficiency can be given operational substance in processes of real-world constitution formation (Lowenberg and Yu, 1992).

In order to produce an efficient social contract or constitution, deliberations must be carried out in a competitive 'constitutional environment'. This condition will be satisfied if an exit option exists for each contracting party. This conclusion is quite consistent with the Wicksell-Buchanan-Vanberg contractarian consensus test. Only in a competitive setting does unanimous agreement acquire operational substance (normative content).

Vanberg (1994) clearly recognizes that the true problem with the agreement criterion is not that it is too demanding but, rather, that it has too little normative content. A criterion needs to be specified which allows one to distinguish between constraints that are judged to make the respective individual choices involuntary, and those that do not. Vanberg's analysis reaches the conclusion that a consistent normative-individualist approach needs to rely on a combined and simultaneous application of a purely procedural, rule-oriented, as well as a substantive, avoidance/exit cost criterion. The avoidance/exit cost perspective arguably provides a more operational specification of the contractarian norm than the notion of a hypothetical contract to which Buchanan (1975, 1977) as well as Rawls (1971) appeal.

The notion of exit has thus been invoked to give more operational substance to the concept of voluntary agreement. It is derived from Albert Hirschman's (1970) classic distinction between exit and voice. Exit (and entry) is an important means by which individuals are able to express their preferences, and is precisely the method through which preferences are revealed in competitive markets for private goods. An exit option introduces an element of market-like competition into the contracting process, which limits the ability of any party to wield power over another party. It is not even necessary that this exit option be exercised, since merely the threat of its use should be enough to restrain rent appropriation. The scope for opportunism is effectively constrained by competition, actual or potential.

Furthermore, it is argued that exit options can help to solve the constitutional maintenance problem by establishing a competitive environment for post-constitutional political and market exchange (Lowenberg and Yu, 1992).

Federalism, once again

The strengthening of regional and local government relative to national government has been advocated by many scholars as an effective way to restrain the growth of legislative redistribution. The existence of separate jurisdictions with some protected powers within a constitutional federation inhibits coercive behaviour by the government. Such an arrangement facilitates migration at low cost between federal subregions and thereby enhances competition between these subregions. The resulting mobility forces competitive governmental units to supply public goods in preferred quantities and to 'price' them broadly in line with relative marginal evaluations.

The foregoing is related to the Tiebout effect (Tiebout, 1956), which says that individuals will sort themselves across communities in accordance with their preferences for the packages of taxes and public goods provided in each community. The ability of the owners of property rights to move to competing jurisdictions protects them from potential rent appropriation by a coercive government. Therefore, it is argued, a federalist constitution can effectively constrain the power of the state. In a federal system, citizens seeking political relief can vote with their feet.

The preceding paragraphs suggest that post-contractual exit opportunities might be characterized in terms of Tiebout competition between different political groupings. If the constitution permits mobility and political plurality, it will help establish and maintain a competitive political post-constitutional environment.[7]

Notes

1. A classic overview of public choice theory is contained in Mueller (2003).
2. Thus Backhaus (1995) contains an analysis of constitutional guarantees of basic rights and procedures, illustrated by three constitutions, the American Constitution of 1789 as amended in 1792, the German Basic Law of 1949 and the Dutch Basic Law of 1983. In addition, reference can be made to several case studies. Holcombe (1991) analyses the role of constitutional rules as constraints on government using three US constitutions: the Articles of Confederation (1781), the Constitution of the United States and the Confederate Consti tution. Geoffrey Brennan and Jose Casas Pardo (1991) examine the Spanish constitution (1978). Sobel (1994) analyses the evolution of two international constitutions: the League of Nations Covenant and the United Nations Charter.
3. See, for example, Hefeker (1995); for some general reflections, see Eichengreen (1994).
4. The problem of time inconsistency has perhaps most notably been investigated in the context of central bank monetary policy; see in this connection Kydland and Prescott (1977) and also Barro and Gordon (1983a and 1983b). For a survey of subsequent elaborations and variations upon the same theme, see, for example, Walsh (2001, ch. 8, pp. 321-84).
5. In *The Power to Tax,* Brennan and Buchanan argue that the existence of potentially huge rent-seeking costs constitutes one of the important arguments for predicting that all rational

individuals, behind a veil of ignorance, would seek to constrain exploitation by revenue-maximizing government to the maximum possible extent. The only way of doing so is to minimize the rents that accrue from 'governing' - that is, by constraining Leviathan so that its surplus is minimal. Government 'surplus', or the income that accrues to government for discretionary use, is defined as $S = R - G$, that is, the excess of revenue collections over spending on specified uses. Since $G = \alpha R$, $S = (1 - \alpha)R$, where α is the proportion of total revenues to be spent on specified public goods and services (Brennan and Buchanan, 1980 [2000], ch. 2).

6. For what may now well become a standard general and formal treatment of the principal-agent model, see Laffont and Martimort (2002).
7. On the significance of the substitutability between intergovernmental competition for fiscal resources and explicit constitutional constraints on governmental taxing power, once the possibility of federalization is introduced, see Brennan and Buchanan, 1980 [2000], ch. 9. These authors' emphasis is on federal assignment as a means of ensuring that individuals have available options as among the separate taxing-spending jurisdictions, and on the effect that the potential exercise of these options has on the total fiscal exploitation in the system. Total government intrusion into the economy should be smaller, *ceteris paribus,* the greater the extent to which taxes and expenditures are decentralized, the more homoge neous are the separate units, the smaller the jurisdictions, and the lower the net locational rents. (ibid., p. 216).

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